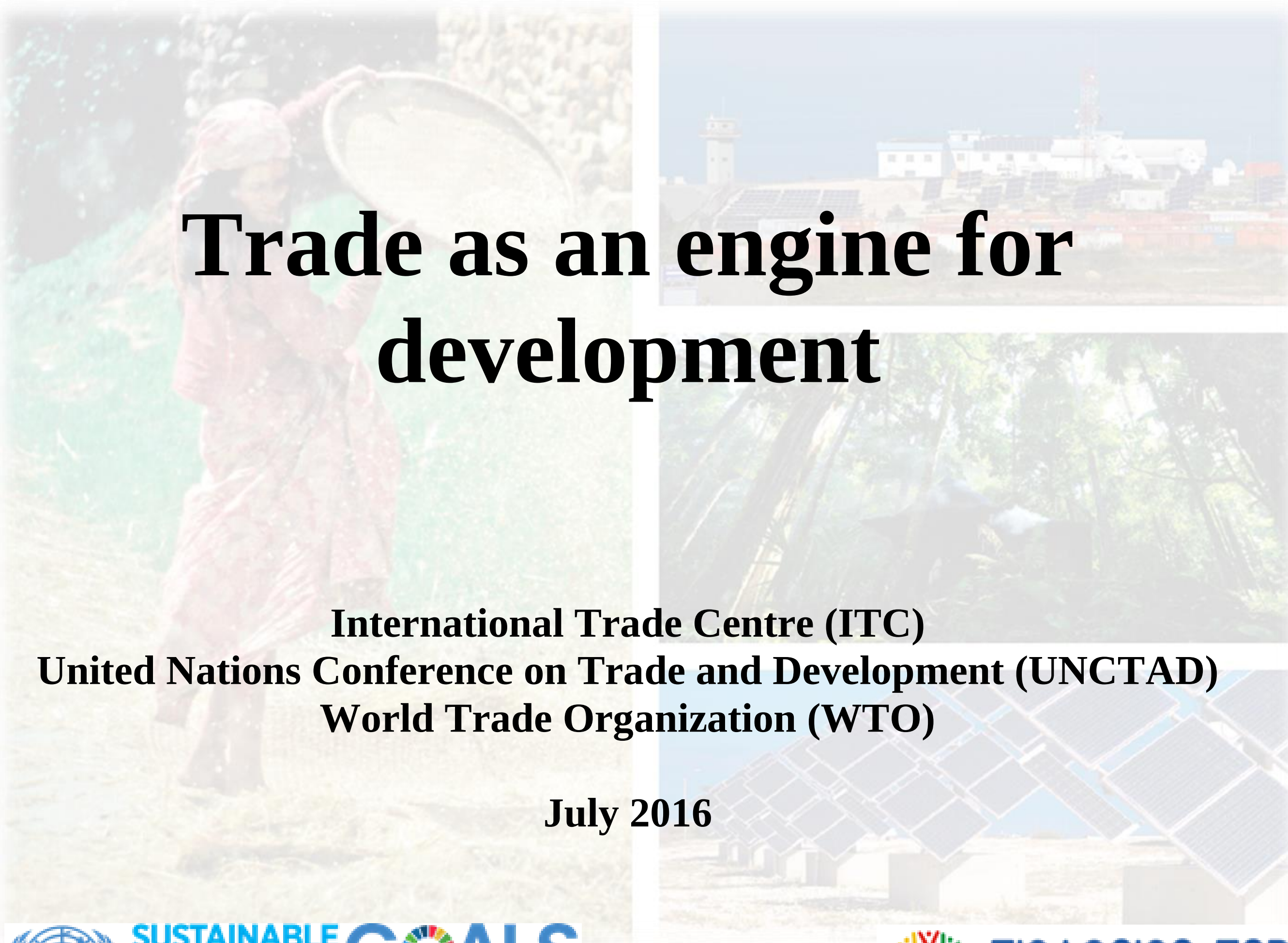
INTER-AGENCY TASK FORCE
ON FINANCING FOR DEVELOPMENT

Issue Brief Series



Trade as an engine for development

International Trade Centre (ITC)
United Nations Conference on Trade and Development (UNCTAD)
World Trade Organization (WTO)

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SUSTAINABLE DEVELOPMENT GOALS
17 GOALS TO TRANSFORM OUR WORLD

FINANCING FOR DEVELOPMENT

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1. Introduction

Trade is recognized as an engine for inclusive economic growth and poverty reduction that contributes to the promotion of sustainable development both by the Addis Agenda of Action (para. 82) and the 2030 Agenda (para. 68). Accounting for a significant share of low-income countries' GDP, international trade can be an important source of finance to both the private sector and the public sector in developing countries. Trade growth enhances a country's income generating capacity, which is one of the essential prerequisites for achieving sustainable development (in line with SDG target 17.11). Trade can also serve as an effective means to facilitate the diffusion of technologies around the world, including of vital green technologies.

A predictable trading environment (as envisaged by SDG target 17.10) can help to promote long term investments that could further enhance the productive capacity of a country. An increase in exports enhances the country's income growth at least at the aggregate level. While an increase in imports at competitive prices can improve consumer surplus and the prospective competitiveness of domestic producers that use imported intermediates. Market access conditions, both foreign market access for a country's exports and domestic market access for imports, are thus an important determinant of the effectiveness of trade as a means of implementation.

On top of that that, open trade relations and closer economic ties also favor regional integration, convergence toward common international best practices and an overall stability of the international trading environment. The concession of preferential treatment for developing and least developed countries on labour intensive products can help diversifying exports and can be beneficial for the reduction of inequality across countries but also within countries (as prescribed under SDG target 10.a and 17.12). Especially on this latter aspect, the Addis Agenda stresses the importance of fostering an inclusive international trade environment that could help SMEs to access GVC and reap the benefits of improved market openness (para. 16 and para. 45). SMEs represent more than 95% of all firms and 60-70% of total employment. Yet SMEs face problems in accessing Global Value Chains and, especially in developing countries, large wage gaps exist between SMEs and large firms deriving from lower productivity. Addressing these problems is also a priority under target 8.2 (increasing levels of economic productivity) and 8.3 (Promote development-oriented policies that support small- and medium-sized enterprises) of the 2030 Agenda in terms of

The main challenges in order to realize the potential of trade to pursue sustainable development and ensure no one is left behind: 1) deepening the multilateral trading system to keep pace with the changing realities of trade, 2) supporting "complementary actions" and policy coherence at the national and regional level in order for trade to serve as a mean of implementation and become a main driver in reducing inequality by ensuring productive employment, inclusiveness of smaller operators, decent work, women's empowerment and food security.

The Multilateral Trading System has had some successes as of late notably with the adoption of decisions on the issues of Trade Facilitation and Export Competition in Agriculture. At the WTO's 9th Ministerial Conference held in Bali in December 2013 an important step towards ensuring inclusiveness in international trade in accordance with the principle of no one left behind was the adoption of a Trade Facilitation Agreement (TFA). This agreement has as its main objectives to reduce the bureaucracy to trade and decrease trade costs. The TFA sets out a series of measures to expedite the passage of goods across borders inspired by best practices worldwide. This will help reduce trade costs at all stages of import and export operations. This means lowering costs to reach the border, at the border and behind the border. By speeding up the clearance of goods across borders, trade facilitation could give a big boost to trade in perishable agricultural products, and is likely to have the same effect on intermediate manufactured goods. The latter are extremely important for integration into global value chains in which the delivery and predictability of the delivery date is essential.

At the WTO's 10th Ministerial Conference held in Nairobi in 2015, WTO Members made a substantial contribution towards achieving the goal of zero hunger (SDG2) through the adoption in Nairobi of the WTO Ministerial Decision on Export Competition. This decision eliminates export subsidies and sets out new rules for export credits, international food aid and exporting state trading enterprises. By ensuring that countries will no longer be able to resort to trade-distorting export subsidies (and measures of equivalent effect) this decision will help to level the playing field in agriculture, aiding farmers in many developing and least developed countries. There remains work to do to eliminate all restrictions and distortions in agricultural markets, but eliminating export subsidies is the most significant reform of global agricultural trade in the history of the WTO – and one which will help to improve the quality of life of future generations, particularly in low-income countries that depend on trade in agricultural products.

Despite recent successes the Multilateral Trading System needs to keep on delivering results in order to adapt to the changing nature of international trade. Some issues that could be explored include measures to support micro, small and medium sized-enterprises, e-commerce, investment facilitation, product regulations and standards, and trade finance.

2. Stocktaking

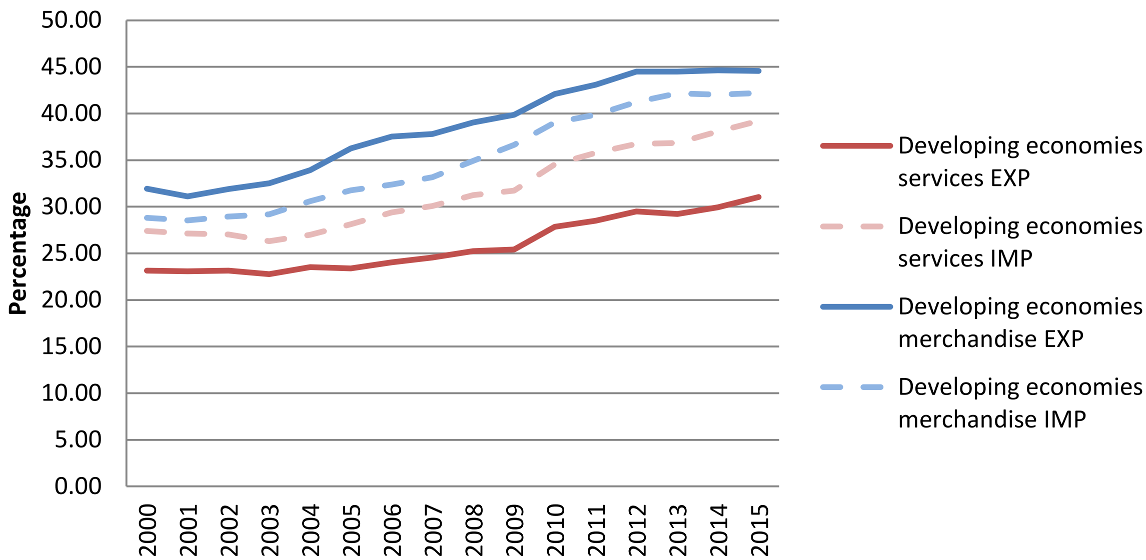
2.1. Export trends: Developing countries' share of global exports grew substantially, but the share of LDC exports remains small

The contribution of developing economies to world merchandise exports has increased significantly since the early 2000s. Developing economies' share of world merchandise exports was estimated to have reached 42%. This together with sustained growth of merchandise imports has resulted in a sharp increase in their participation in global flows, reaching over 40%

in 2015. Nevertheless, both export and import participation during the period 2012-2014 rose only modestly, marking a slowdown from the swift growth of past years.

Developing economies play an increasingly important role in trade in commercial services. Rising imports of commercial services boosted developing economies' participation in world imports, which expanded from 28% in 2005 to 39% in 2015. However, since 2012, the share increased by only around 1 percentage point. The share of developing economies in world exports rose at a slower pace, from 23% in 2005 to 31% in 2015.

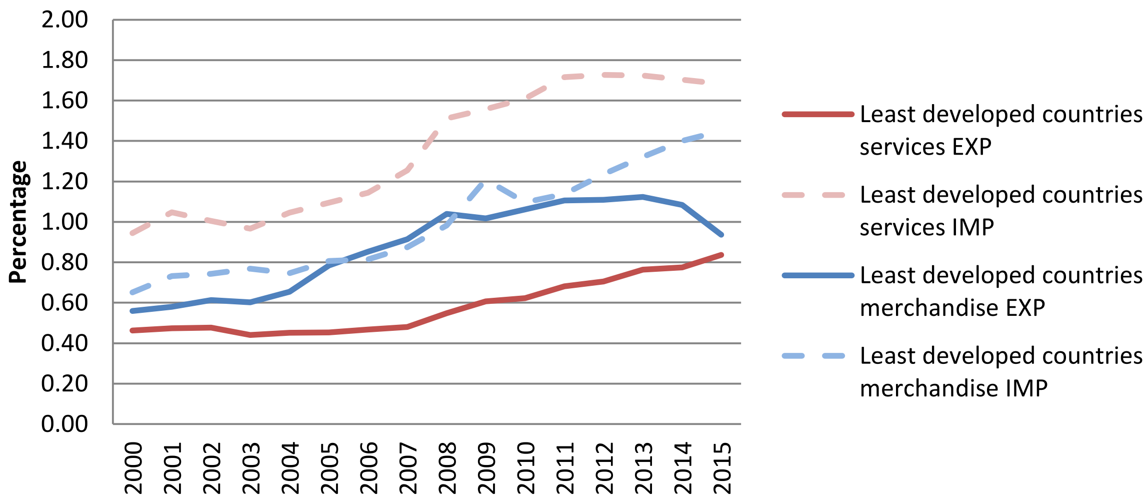
Figure 1: Developing countries share of global exports and imports of goods and services



In the case of LDCs, their share in world exports almost doubled, from 0.6 per cent in 2000 to 1.1 per cent in 2014. One of the key drivers of export growth during this period was an increase in the prices of fuels, ores and metals, reflecting the high demand in developing countries, notably China. The share of LDCs in world merchandise imports grew even faster over the same period, from 0.7 per cent in 2000 to 1.4 per cent in 2014, reaching approximately US$ 246 billion.

The last 3 years have witnessed an increasing divergence in the share of exports *vis à vis* the share of imports of goods by LDCs. A similar but more significant trend can be observed in the share of services exported by LDCs from 2005, reflecting the lower competitiveness of LDCs in this sector relative to trade in goods. Nevertheless, this trend has been changing from 2011 onwards as the import share has remained almost stable (1.70%) against a steadily increasing share in global exports (moving from 0.68% to 0.78%); this has resulted in that for 2014 the trade balance of LDCs remained largely negative.

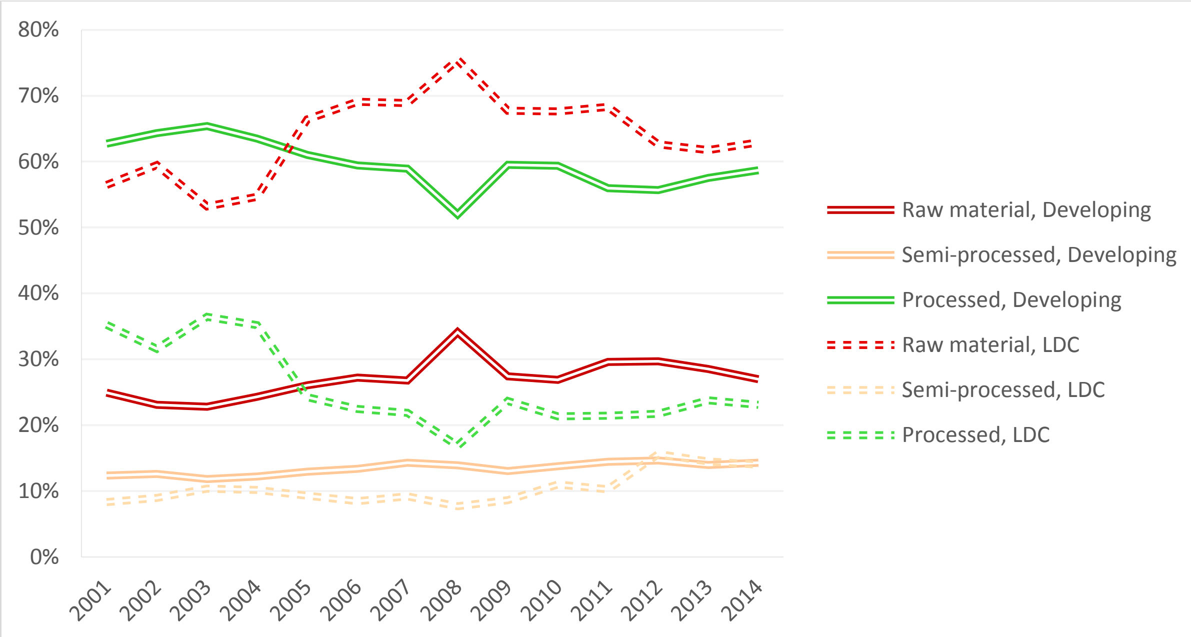
Figure 2: LDCs share of global exports and imports of goods and services



When merchandise exports, are analyzed focusing on the processing value of the products traded, the picture that emerges is however less optimistic. LDCs are still heavily reliant on raw materials which share represents more than 60% of their export basket in 2014 (only 27% in the case of developing countries)[1]. Oil alone makes up to 20% of LDCs exports. On the other hand, the share of fully processed goods exported by LDCs and developing countries has been declining over time (from 32% in 2001 to 23%in 2014). A slightly negative trend is also observable for developing countries where however, processed goods represent the main export. In 2014 the share of semi processed product is equal to 14% for both LDCs and developing countries.

Figure 3: Share of LDCs' and developing countries' exports by level of processing

[1] Excluding oil products, the percentage share of raw materials goes down to 43% in LDCs and 14% in developing countries.



Overall, the amount of South-South trade accounted for more than half of exports among developing countries[2]. The contribution of South-South trade to developing economies' exports continued to grow and, in 2014, accounted for 53.9% of developing economies' exports. South-South trade grew by 6% between 2012 and 2014. On the other hand, developing economies' trade with developed and CIS countries remained relatively flat, with exports only increasing by 1% and imports by 2%. Intra-developing Asia trade, which accounts for 47% of South-South trade, showed a 9% increase between 2012 and 2014. However, growth of South-South trade was not as dynamic compared to the period 2010-2012, when it grew by 33%. China continued to be a major player in South-South trade. In 2014, China absorbed 8% of Latin America's exports, and 11% of Africa's and Middle Eastern exports. However, its demand for raw materials and commodities slowed in 2014. This contributed to a, drop in commodity prices. Given this changing situation it is important that the international community remain vigilant to ensure that past gains are not undone in the current cycle.

Doubling the LDCs' share in the next 4 years, as envisaged by the Istanbul Agenda of Action and reflected under the SDG target 17.11, will require significant improvement in market access provided by main trade partners, such as the G-20 group which accounts for 85% of world GDP and is the destination of 80% of LDCs' exports.

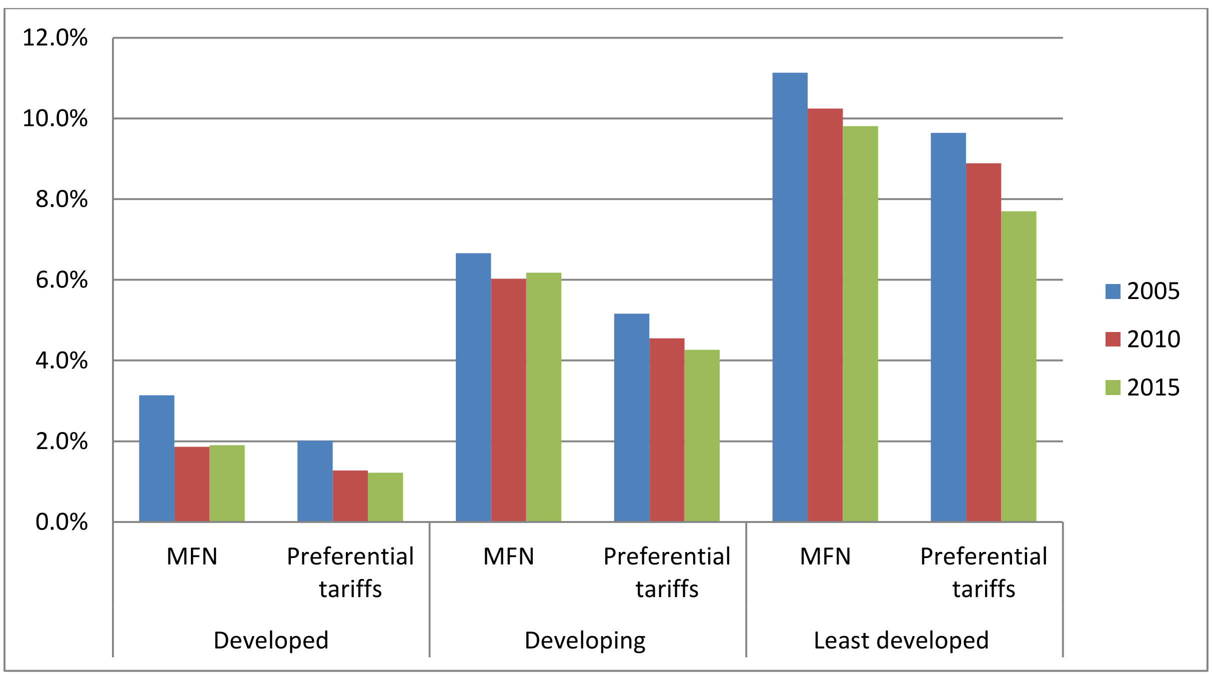
2.2. Market access conditions: Developed countries' average tariffs have been declining overtime but higher tariffs imposed by developing and LDCs on key sectors might affect the expansion of South-South trade

[2] See http://www.un.org/millenniumgoals/pdf/MDG_Gap_2015_E_web.pdf, p. 25.

Tariffs applied to imported goods have been decreasing over time across developed, developing and least developed countries. Key drivers of this global trend are the progressive liberalization achieved under the multilateral trading system, as well as, the expansion of preferential market access under regional trade agreements, unilateral tariff liberalization and non-reciprocal preference schemes in recent years. Average applied tariffs; whether MFN (i.e. applied within the framework of the multilateral trading system) or preferential (related to bilateral or regional trade agreements and unilateral preference schemes) vary widely across country groups reflecting the importance of this trade policy tool for countries with lower income levels. LDCs and Developing countries yet rely more heavily on this trade policy as a revenue generator. This could represent a constraint to the expansion of South-South trade.

The lowest average tariffs (i.e. preferential tariffs) faced by products entering developed, developing and least developed countries are respectively at 1.2 percent, 4.3 per cent and 7.7 per cent. There is also great variation in tariff protection across sectors. In 2015, agriculture (among developing countries) and clothing (among developed and least developed countries), followed by textiles, remain the sectors where exports face the highest tariffs[3].

Figure 4: Import tariffs applied under the multilateral system and preferential agreements



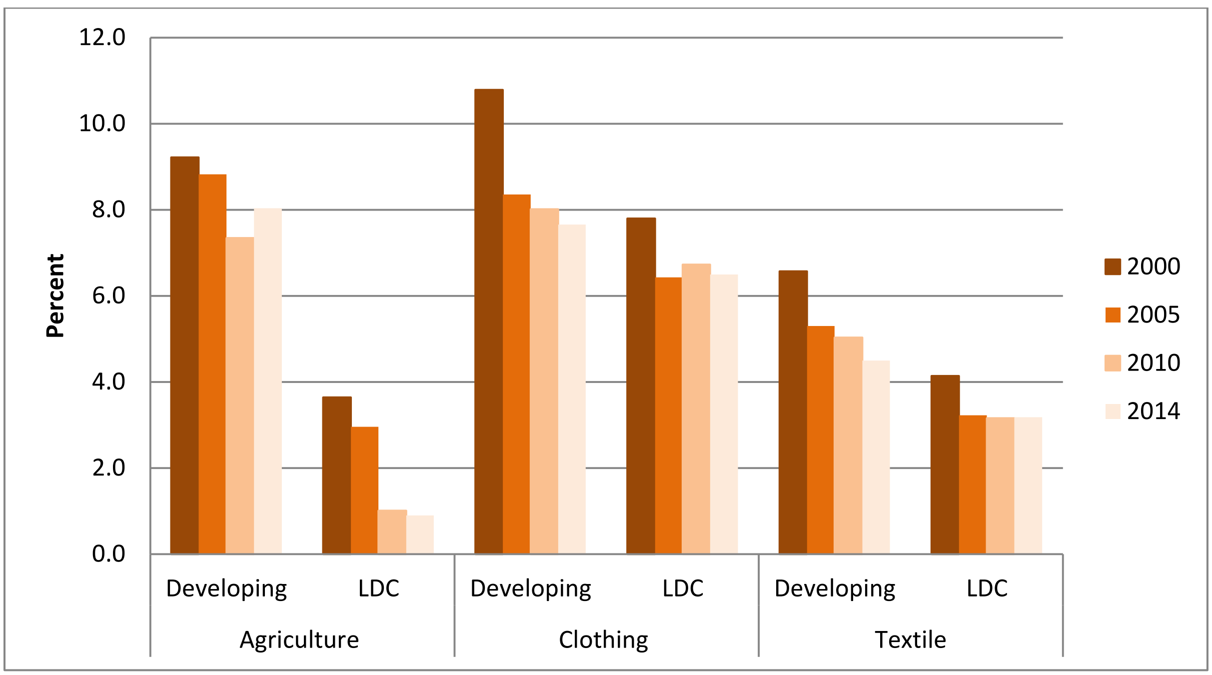
Average tariffs imposed by developed countries on imports from LDCs declined steadily for all product groups until 2005. After that year, the decline continued only for agricultural products, with average tariffs amounting to less than 1 per cent in 2014. Higher tariff rates still exist on

[3] Large variations can also be observed across regions. In Asia agricultural products are applied tariffs of up to 26%, while Sub-Saharan Africa and Oceania impose the highest tariffs on clothing.

clothing and textiles exports for LDCs due to the exclusion of some large Asian exporters from certain preferential tariffs, notably in the US. The majority of G-20 members apply non-reciprocal preferential tariffs to LDC exports. The trade-weighted average tariff facing LDCs' exports in G-20 market is at 1.3 per cent[4]. An increasing number of developing countries have also taken concrete steps to improve market access opportunities for LDC exports.

Although improvements in preferential tariff treatment for LDCs have slowed down in some key sectors, the relative preferential margins enjoyed by LDC exports, intended as the difference between the preferential tariff rate applicable to exports from LDC and the corresponding MFN rate, have improved over time. Agriculture is the sector where LDCs benefit from the largest margin of preference compared to other developing countries. In the case of textiles and clothing the preference margin, which is just above 1 percentage point, has not changed much in recent years.

Figure 5: Average tariffs levied by developed countries on key products exported by the LDCs (percentage)

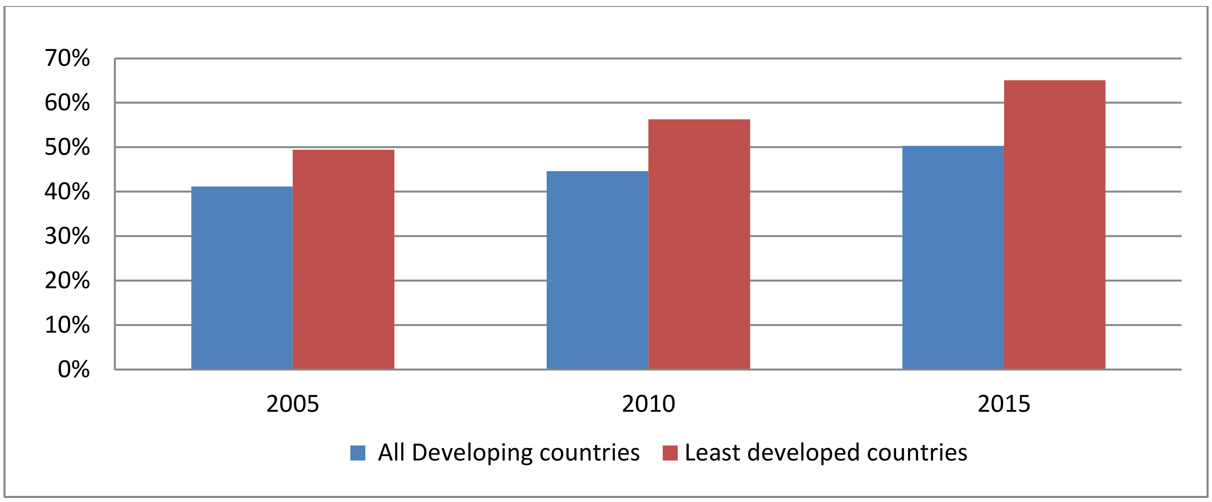


[4] Note, however, the simple average tariff is much higher at 5.2 %. This reflects the fact that significant tariff barriers, e.g. in the form of tariff peaks at the rate exceeding 15%, still apply to LDCs' exports particularly in the "sensitive" sectors such as agriculture, apparel and textile.

2.3. Duty free-Quota free treatment for Developing countries and LDCs: Difficulties to assess the impact of tariff exemptions

With relatively small year-to-year fluctuations, LDC and developing countries' duty-free market access continued improving in recent years. Developing countries have seen the number of lines free of duties increasing from 41% in 2005 to 50% in 2015. In the case of LDCs the trend has also been improving overtime moving for from 49% in 2005 to 65% in 2015. Most developed Members today grant either full or nearly full duty-free access to LDC products.

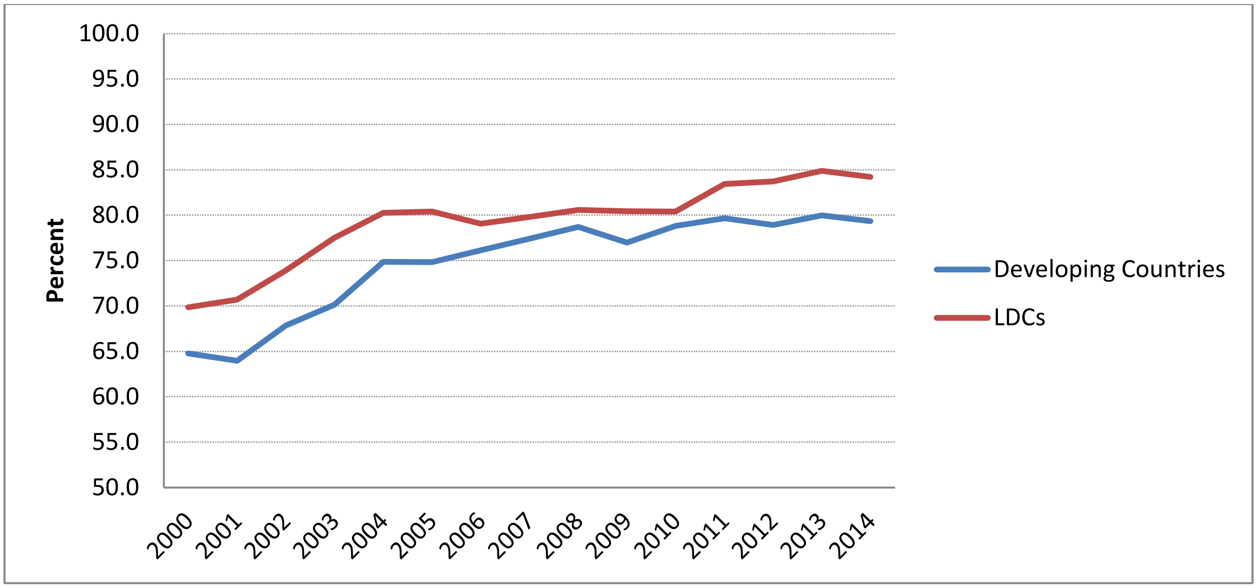
Figure 6: Proportion of tariff lines applied to imports from LDCs and developing countries with zero-tariff



In 2014, 79% of developing country exports (excluding arms and oil) benefit from a duty-free treatment when imported by developed countries and this ratio rises to 84% in the case of products exported by LDCs. Duty free imports under MFN treatment has been increasing through time as WTO members reduced their applied duties and entered into sectoral agreements such as the Information Technologies Agreement. A closer analysis further shows that most of the decline observed for developing countries is accounted for by an increase in dutiable exports to the EU after the revision of the list of GSP beneficiaries and the graduation of a number of developing or CIS countries.

For LDCs, almost 100% of agricultural products exported by the LDCs are imported free of duty by the developed countries. However, in the case of manufacturing exports, in particular clothing exports, which are the most dominant manufacturing item for the group, the proportion of duty-free imports by developed countries was about 75% over the recent years.

Figure 7: Share of imports from LDCs and developing countries entering duty-free into developed country markets (excluding oil and arms; percentage)



When looking at preferences, the nature of the competitive advantage remains significant for LDCs. About 60% of LDC exports benefit from true preferential treatment, being exempted of duties on items that are normally dutiable, such as agriculture or clothing. This ratio has steadily increased in the recent years. In contrast, most of developing country exports that are duty-free receive this treatment under the MFN treatment, thus without gaining any particular competitive margin over other exporters.

Based on available information, the margin of preference granted to LDCs relative to MFN treatment increased rapidly after 2006. In 2013, the margin of preference was on average of 5 percentage points, excluding oil. Clothing and textiles exports received the highest preference margin (9.6 and 6.8 percentage points less than MFN tariffs, respectively). The margin was also significant on agricultural products at about 4 points. However, in the absence of consistent datasets on preference utilization, it remains difficult, to assess the actual impact of tariff exemptions and the reasons that prevent importers from taking advantage of these preferential schemes.

2.4. Non-tariff measures and trade costs

Another element that determines the market access conditions is non-tariff measures (NTMs), such as product regulations and requirements that traded goods need to comply with. A large share of NTMs in G-20 consists of sanitary and phytosanitary (SPS) measures and technical barriers to trade (TBT), which are prevalent particularly in the sectors where tariffs facing LDCs remain high, i.e. agriculture, apparel and textile. Many NTMs add administrative burden and increase overall costs for exporters, and these costs tend to be higher for LDC exporters due largely to institutional, infrastructural and technological lack LDCs suffer.[5] In 2015, WTO

[5] UNCTAD (2012), Non-tariff measures to trade : Economic and policy issues for developing countries (UNCTAD/DITC/TAB/2012/1).

Members submitted 1,438 new notifications of technical regulations and conformity assessment procedures. Since 2007, Members have submitted more than 1,000 new notifications annually with that figure increasing to 1,500 since 2012. In other words, lowering trade-distortionary impact of NTMs would significantly enhance LDCs' exporting opportunity. According to UNCTAD's estimate, if G-20 fully liberalize its market to LDCs by providing (i) the complete tariff-free market access and (ii) eliminating distortionary impacts of NTMs, LDCs' exports to G-20 would be increased at least by US$33 billion, or at least by 25%.[6]

In many cases the same measures applied by the domestic ruling authorities and, particularly, the administrative procedures in place for their implementation are the most constraining barriers to trade. Findings from business surveys series, conducted on more than 20 countries, reveal that more than 25% of reported problem correspond to measures applied by the home country of the exporting company.[7] This leaves room for improvement for domestic authorities in the development of their regulatory requirement frameworks. The challenges imposed by NTMs are also a heavier burden for SMEs which are less prepared than larger firms to cope with the cost of regulatory compliance and access to information.

Other temporary trade barriers as antidumping duties, countervailing duties and safeguards, can also undermine the predictability of market access conditions. The current use that have been done of these trade policy tools, allowed within the framework of the WTO agreement, might put at stake the economic relations build by partner countries through the adoption of retaliation practices. Their analysis should be included to provide a full picture of trade costs.

3. Policy options and recommendations for corrective actions

- **Reduce trade costs:** High transactional and transportation costs negatively affect Developing Country and LDC competitiveness. Adoption of trade facilitation measures including full implementation of the WTO Trade Facilitation Agreement will make it possible for smaller enterprises to join international markets and ensure that international trade is truly inclusive and aligned with the SDG principle that no-one should be left behind.
- **Focus on export diversification and level of processing:** Exports from developing countries and LDCs in particular still hinge on raw materials that present high volatility. Diversification remains therefore a high priority. To assist with their diversification efforts developing countries and LDCs will need to continue benefiting from preferential market access conditions and productive capacity building.

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[6] Nicita, A. and Seiermann, J., G20 policy and LDC export performance (UNCTAD, forthcoming in 2016).

[7] ITC (2015), The invisible barriers to trade – How Businesses Experience Non-Tariff Measures, Available at http://www.intracen.org/uploadedFiles/intracenorg/invisiblebarriers.pdf

- **Build Supply side capacity and trade related infrastructure through Aid for Trade:** The international community needs to continue to mobilize resources for developing countries and LDCs to build supply capacity, strengthen trade-related infrastructure, and add value to exports. This should be done through targeted, focused and predictable Aid for Trade support.
- **Boosting the services sector**: The services sector provide inclusive development potential given their large share in GDP and employment. In fact, this sector is particularly important due to its impact on the integration of developing countries in Global Value Chains especially if they lag behind in the physical infrastructure required for trading in merchandise goods.
- **Rules of origin and utilization of preference schemes**: The specificity, design and application of rules of origin can make it difficult for LDC exporters to benefit from preference schemes. Strict rules of origin (or regional cumulation) were justified on the ground that they help in promoting integrated production structure in the recipient country. Seeking coherence in the rules of origin for both RTAs and preference schemes would help business deal with the complexities of structuring their production to take advantage of market opportunities created by these arrangements.
- **Reduce the distortionary effects of NTMs:** A majority of NTMs are legitimate policy tools aiming at consumer protection and environmental sustainability in the importing country. Reducing the trade distortionary effects of these measures needs to be achieved by: (i) ensuring that regulatory framework of importing countries does not discriminate; (ii) ensuring that even in the absence of discrimination the measure is not more trade restrictive than necessary; (iii) ensuring that technical and financial assistance is available for developing country and LDC exporters to comply with regulatory requirements in importing countries, including with conformity assessment, and to participate effectively in the development of international standards; and (iv) ensuring that the administrative procedures required to implement said measures are efficient and adequate.
- **Deepening the Multilateral Trading System to adjust to the changing realities of trade:** This includes exploring steps to support micro, small and medium sized-enterprises, e-commerce, investment facilitation, product regulations and standards, and trade finance.
- **Policy action and capacity building for SMEs:** Trade potential, and thus growth potential, may hence be lost if trade policies do not provide for the identification and removal of trade barriers, allowing for the inclusion of SMEs into global value chains. At the same time, knowledge needs to be transferred to exporters and importers to strengthen the capacity of producers, exporters, policymakers and buyers, to participate in more sustainable and inclusive production and economic growth, e.g. through compliance with sustainability standards allowing to tap into new export opportunities.
- **Data availability for progress monitoring:** Supplementary indicators (e.g. export diversification, level of processing of the products exported, preference utilization rates and even firm level information) will allow providing contextual data and enhancing our understanding of the backward and forward linkages among trade, sustainable development and poverty reduction.